

A Brief on the New Saudi Franchise Law

IN THIS ISSUE:

Background

What is Franchising?

Scope of Application

Summary of Key Provisions

Background

The new Franchise Law (the “**Franchise Law**”) of the Kingdom of Saudi Arabia (the “**Kingdom**”) was promulgated by Royal Decree M/22 dated 09/02/1441 Hijri (corresponding to 8 October 2019) and will come into effect in April 2020. The Ministry of Commerce and Investment (“**MOCI**”), the ministry in charge of administration and implementation of the Franchise Law, has been tasked with issuing the Implementing Regulations (the “**Implementing Regulations**”) of the Franchise Law by the time the Franchise Law becomes effective.¹

This article provides a brief overview of some of the key provisions of the Franchise Law.

What is Franchising?

The Franchise Law defines franchising as “the granting by a person referred to as the franchisor to another referred to as the franchisee of the right to carry out the activities—subject of the franchising—for its own account under the trademark or the trade name owned by the franchisor or licensed to it, providing technical expertise and know-how to the franchisee and determining the manner of operating the franchised business, against monetary or non-monetary consideration, which consideration shall not include the amounts paid by the franchisee to the franchisor for goods and services supplied.”²

In order to qualify for franchising, the activity that is subject of franchise must have been carried on by two persons (who may be the franchisor or one of its group members) for at least one year, or at least in two different locations.³

¹ We will provide a further update regarding the Franchise Law once its Implementing Regulations have been published.

² Article 1 of the Franchise Law.

³ Article 5 of the Franchise Law.

Scope of Application

The Franchise Law applies to any franchise that is to be implemented in the Kingdom.⁴ Certain contracts and arrangements are excluded from the scope of the Franchise Law such as contracts that are regulated by the Commercial Agencies Law and contracts for the use of trademarks or any other intellectual property rights in relation to goods and services.⁵

Summary of Key Provisions

- **Mandatory disclosure:** The franchisor has now a statutory obligation to disclose certain information (to be specified in the Implementing Regulations) to the franchisee before the conclusion of a franchise agreement.⁶
- **Mandatory registration:** Franchise agreements must be registered with MOCI.⁷ The registration procedure will be set out in the Implementing Regulations.
- **Terms of franchise agreement:** The Franchise Law requires a franchise agreement to include a number of substantive provisions.⁸ Among such mandatory provisions is the franchisor's obligation to transfer know-how; obligations of supply and purchase of goods or services from a specific source, the franchisee's right to grant sub-franchises and consequences of change of control of either party. The Franchise Law allows the parties to contract out from a number of such mandatory provisions which provides the parties with flexibility to make a contract on terms they like.
- **Termination rights and compensation:** The franchisor may terminate the franchise agreement in a limited number of scenarios:⁹
 - the franchisee's breach of contractual obligations;
 - winding up or insolvency of the franchisee;
 - suspension by the franchisee of the franchised business for more than 90 consecutive days;

⁴ Article 3 of the Franchise Law. The Royal Decree, which promulgated the Franchise Law, disapplied Articles 5 (franchisor experience required), 6 and 7 (registration and disclosure), 8(2) and 9(2) (franchisor's obligations), 11 (content of franchise agreement), 17 and 19 (termination and compensation for the franchisor's breach of its disclosure and registration obligations) to franchise agreements existing prior to the Franchise Law to take effect.

⁵ Article 4 of the Franchise Law.

⁶ Article 7 of the Franchise Law.

⁷ Article 6 of the Franchise Law.

⁸ Article 11 of the Franchise Law.

⁹ Articles 16, 17 and 18 of the Franchise Law.

- if the franchisee's conduct poses a risk to public health or safety;
- the franchisee's material violations of laws of the Kingdom by the franchisee or infringement of the franchisor's intellectual property rights; and
- other circumstances agreed in the franchising agreement.

Under Article 17 of the Franchise Law, the franchisee is entitled to terminate the franchise agreement if the franchisor is in material breach of its disclosure and registration obligations under the Franchise Law without any liability to the franchisor for such termination.¹⁰ Termination of the franchise agreement under Article 17 has two implications: (i) the franchisor must within 60 days of the franchisee's demand to re-purchase any asset bought by the franchisee for the franchised business on the basis of instructions from the franchisor (irrespective of whether such assets were bought from the franchisor or third parties); and (ii) the franchisor must compensate the franchisee "for any losses suffered in relation to setting up, acquiring or operating the franchise business in the Kingdom and any other damages suffered by the franchisee."¹¹

- **Change of control:** Unless agreed otherwise in the franchise agreement, any change of control of the franchisee or assignment of the franchise agreement by the franchisee requires the prior approval of the franchisor.¹² The franchisor is not permitted to withdraw and withhold its consent save in certain situations (e.g. the assignee lacks sufficient financial resources or the franchisee owes money to the franchisor).¹³ If the franchisor fails to respond (within the period to be specified in the Implementing Regulations) to the franchisee's request to approve a change of control or assignment, such approval is deemed to have been made by the franchisor.

¹⁰ It is worth noting that Article 19 of the Franchise Law allows the franchisee to claim compensation (without terminating the franchise agreement) if the franchisor materially breaches its disclosure and registration obligations.

¹¹ Article 20 of the Franchise Law. The re-purchase obligation of the franchisor will also be triggered when the franchisor does not extend or renew the term of the franchise agreement (Article 20(1)(A) of the Franchise Law).

¹² Article 13 of the Franchise Law.

¹³ Article 13 of the Franchise Law.

- **Dispute resolution:** The parties may agree on using arbitration, mediation or conciliation to resolve any disputes regarding the franchise agreement or the application of the Franchise Law.¹⁴ The Franchise Law contemplates the establishment of a committee comprising of three members with jurisdiction over matters involving violations of the Franchise Law. The committee may impose fines not exceeding SAR 500,000 for violations of the Franchise Law.¹⁵ Decisions of the committee can be appealed to the Board of Grievances which adjudicates claims against the government.

¹⁴ Article 25 of the Franchise Law.

¹⁵ Article 24 of the Franchise Law.

CONTACTS



MARWAN ELARABY
EMEA Regional Managing
Partner
Abu Dhabi / Dubai
T: +971.2.410.8123
T: +971.4.249.2123
[marwan.elaraby@
shearman.com](mailto:marwan.elaraby@shearman.com)



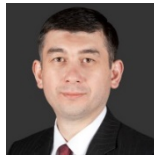
DR. SULTAN ALMASOUD
Partner
Riyadh
T: +966.11.213.7801
[sultan.almasoud@
shearman.com](mailto:sultan.almasoud@shearman.com)



MATTHEW POWELL
Partner
Abu Dhabi / Dubai
T: +971.2.410.8125
T: +971.4.249.2125
[matthew.powell@
shearman.com](mailto:matthew.powell@shearman.com)



BRENDAN HUNDT
Counsel
Riyadh / Dubai
T: +966.11.213.7805
T: +971.2.249.2160
[brendan.hundt@
shearman.com](mailto:brendan.hundt@shearman.com)



SANJARBEK ABDUKHALILOV
Consultant
Riyadh
T: +966.11.213.7802
[sanjarbek.abdukhalilov@
shearman.com](mailto:sanjarbek.abdukhalilov@shearman.com)

ABU DHABI | AUSTIN | BEIJING | BRUSSELS | DALLAS | DUBAI | FRANKFURT | HONG KONG | HOUSTON | LONDON | MENLO PARK | MILAN | NEW YORK
PARIS | RIYADH* | ROME | SAN FRANCISCO | SÃO PAULO | SEOUL | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2020 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.

*Dr. Sultan Almasoud & Partners in association with Shearman & Sterling LLP